Chapter 2

The Urgent Need for Labor Freedom in Europe—and the World

Johnny Munkhammar

For several weeks during the autumn of 2005, riots raged in the streets of Paris. Every night, hundreds of cars were burned, shops were vandalized, and violence ruled. French President Jacques Chirac concluded that his nation was suffering from a profound "malaise," a word that indeed captures the reality of economic and social problems in many European countries. After centuries of economic leadership, Europe must now face the truth that its governing institutions—especially its labor markets—are deeply flawed. Those who finally took to the streets, native and immigrant citizens alike, were severely affected by unemployment.

France may be the most stubborn defender of the so-called European social model, characterized by vast government intervention in the economy, but many other governments in Western Europe are committed to the same philosophy. Presidents and prime ministers devote speeches to nostalgic messages and promise to maintain and protect the existing social model. Their rhetoric translates into policies that are a new kind of protectionism for traditional jobs, a protectionism that is reflected in the widespread official resistance to a single European Union (EU) market in services, disapprovals of business mergers, and an anxious debate about the "Polish plumber" representing free flows of labor within the EU.

We Europeans are clearly at a crossroads. Either we look to the future and learn from successful market-oriented reforms, or we look back to the past and continue trying to shield old occupations from international economics. It is a choice between openness and protectionism, between modernization and nostalgia—indeed, between government intervention and freedom itself. The problems of Europe are not born overseas, but are innate to the process of internal economic development and change. That is why a tighter adherence to a failing model will only exacerbate current problems and lead to more unrest in European cities. Rioting and decline is a destiny that no European wants to face.

Yet there is reason for optimism. Never before have so many countries been so deeply involved in the global economy, and the benefits of globalization—economic growth, employment, and competition—are ever clearer. Never before have so many countries made successful free-market reforms, which is an inspiration for others. Almost all European countries can point to at least one successful reform, and as we copy each other's successes, the future should rapidly become much brighter.

In my view, of all the areas that are still in need of substantial reform, the most important is the labor market. People—especially the young—want jobs and freedom, not dependence on government.

THE LABOR MARKET AND OTHER MARKETS: A FUNDAMENTAL DIFFERENCE?

Critics have difficulty seeing labor as a market like other markets. In the public debate, it is often assumed that there is a fundamental difference between the labor market and other markets. "Bananas can be traded freely in the market," the argument goes, "but people are not bananas. In the labor market, we need government intervention." Even assuming there is a difference, however, one might ask: Should bananas have more freedom than workers? Is the market for labor truly unique in the way that critics suggest?

My answer is no. The free market is a superior institution for labor, yielding the best results for society and workers, just as the free market has proven superior for virtually all other fields. Furthermore, government intervention produces the same problems in the labor market that it produces in any other market. Finally, in a globalized world, a free labor market is increasingly important as a way to make workers more competitive and, ultimately, better compensated.

The addition of the new labor freedom factor to the *2007 Index of Economic Freedom* is thus highly relevant. The elements that comprise this new category encompass several common restrictions on freedom that produce consequences for the labor market. Freedom is just as essential in the labor market as it is in any other market; indeed, it is fundamental to the concept of economic freedom.

MARKET PRINCIPLES AND DEREGULATION

The core principle of a market is free, voluntary exchange. That principle has several components: free choice, free pricing, and free competition. Today, in scholarly research or policy debates, it is generally accepted that the free market leads to constant improvements. A thousand consumer goods compared over time reveal the relentless impact of competitive pressure for innovation, price reduction, and consumer prosperity. Consider the DVD disc technology now sweeping away the VHS tape, which itself was an innovation two decades ago.

A more profound lesson is that whole societies are similarly superior to others, at least in purely economic terms. A comparison between the free economies in Europe versus the centrally planned economies reveals much. A BMW is better than a Trabant, the poorly manufactured, expensive, and polluting cars made in the former East Germany.

Innovators and entrepreneurs compete to satisfy consumers. Free exchange is good in a town, better in a country, and best in every country: more minds, more ideas, more people that want to create something new. The globalized economy has enlarged markets and increased specialization. Competition means lower consumer prices, a broader supply, and better quality. Improvements in everyday life on a global scale constantly confirm the textbook theories.

The free market unleashes creativity and change. It has been estimated that three-quarters of all products today did not exist in any form 100 years ago.[1] Joseph Schumpeter's point about destruction of the old being a nec-

1 William D. Nordhaus, "Do Real-Output and Real-Wage Measures Capture Reality? The History of Lighting Suggests Not," in Timothy F. Bresnahan and Robert J. Gordon, eds., *The Economics of New Goods* (Chicago: University of Chicago Press, 1997).

essary condition for creation of the new is both relevant and visible in society.[2] Some 150 years ago in Western Europe, three-quarters of the population was employed in agriculture versus about 3 percent today, and today's farmers produce more total output. Innovation in economic efficiency is therefore interwoven with the changing composition of the labor force.

LABOR MARKET INTERVENTION IN THEORY

As the types of work and jobs changed during the Industrial Revolution, governments required better general treatment of workers. A minimum wage became common, as did other regulations mandating that businesses limit the number of hours each worker could contribute per week. As prosperity advanced, so did the multitude and variety of labor regulations.

Government interventions in the labor market are not limited to wages or hours; they also affect hiring and firing practices, workplace rules, safety, and even the kind of language allowed. In various ways, the interventions also decide how, with what, where, and when people work. Government also affects pricing through taxation and trade union privileges, notably collective bargaining. Finally, governments often mandate social insurance systems, such as pensions. Unlike many other government programs, regulatory structures normally impose costs that are invisible to the public simply because they do not show up on government budgets.

Why do governments intervene in labor markets? Three possible explanations are commonly cited: (a) to make the labor market more efficient, implying greater per capita incomes; (b) to gain political power; or (c) as a natural consequence of different legal systems. A 2004 Harvard study of 85 countries empirically tested the three theories and found no support for the efficiency theory. On the contrary, the researchers showed that heavy regulations in the labor market produced adverse consequences for employment. But they did find significant support for the other explanations: a clear connection between higher regulation and leftist governments and substantial evidence that legal origin countries have more labor market regulations than common law countries.[3]

Countries with more left-leaning governments tend to enact stricter labor regulations, which yield adverse efficiency results. The main reason behind most of the interventions, however, is a perception of reality: the fear of a "race to the bottom." In other words, preventing "social dumping" motivates intervention. Skeptics have long warned that wages and other working conditions will decline in a pure free market. This skepticism has roots in the Marxist notion of capitalism, which retains its appeal even though economic history has hardly been kind to the theory in practice.

In Western Europe, on average, wages are roughly 10 times higher today than they were a hundred years ago because our productivity today is that much higher. We produce, per person, 10 times more value, which is why we get more pay. If we had not increased productivity, no regulations or trade unions in the world could have created such tenfold wage increases. Moreover, if wages in a free market are set below productivity, a competitor will benefit from offering the employees a higher wage. Thus, "social dumping" is largely a myth. Those who argue that labor protections are essential for a higher quality of life should ponder this point, as well as the material misery of countries that embrace such policies.

Why else would the world's highest wages be found in the United States, where the labor market is relatively free and only some 10 percent of the labor force are members of trade unions?[4] Why else would multinational companies voluntarily pay workers in, for example, China 30 percent higher wages on average than old, state-owned, industries do? And why did the average

2 Joseph Schumpeter, *Capitalism, Socialism and Democracy* (New York: Harper, 1975).

3 Juan C. Botero, Simeon Djankov, Rafael La Porta, Florencio Lopez De Silanes, and Andrei Schleifer, "The Regulation of Labor," *The Quarterly Journal of Economics*, November 2004.

4 See International Labor Organization Web site at *http://laborsta.ilo.org/*.

wages rise by three times in foreign-owned companies during the past 10 years?[5] The desire to make a profit in a free market benefits not only consumers, but also workers.

Karl Marx and Friedrich Engels pointed out that capitalism—in 1848—had created more wealth than had been experienced by all previous human generations combined,[6] but they thought that an elite group of capitalists would eventually capture all the wealth and leave workers poor. They were proven totally wrong. The global explosion of living standards—for all people, not just the rich—since that time is breathtaking, and it has happened to the largest extent in countries that followed Marx's and Engels' recommendations the least.

RESULTS OF FREE MARKETS VS. INTERVENTION

Massive state interventions in the labor market are thus founded on a romantically appealing but scientifically void theory of how the market works. In practice, the distortions generated by limiting labor freedom follow suit. Europe happens to be a very telling showcase for both regulation and deregulation in the labor market.

In Western Europe, the labor market is often highly regulated. The share of the working-age population employed in EU countries is only 64 percent,[7] and this really says little. "Working age" between the ages of 15 and 64 really should be redefined because people live very long and healthy lives today, compared to when the definition was established decades ago. The U.S., of course, is far from a free-market heaven, but its labor market is freer than those found in most of Western Europe, and the U.S. employment rate is 72 percent.

Consider that between 1970 and 2003, employment in the U.S. increased by 75 percent. In France, Germany, and Italy, it increased by 26 percent.[8] In 2004, only 13 percent of unemployed workers in the U.S. were unable to find a new job within 12 months; in the EU, the figure was 44 percent.[9] In the EU, average youth unemployment is 17 percent. In the U.S., it is 10 percent.[10]

But the best comparisons can be made within Europe itself. Denmark has an employment rate of 76 percent, but Poland is far lower at 53 percent. Youth unemployment is above 20 percent in Greece, Italy, Sweden, France, Belgium, and Finland and below 8 percent in Ireland, the Netherlands, and Denmark.[11] In the EU's 15 member states, between 1995 and 2004, the development of employment was also very different between the countries. In Ireland, the Netherlands, and Spain, the increase in employment was the highest; in Germany and Austria, it was almost zero.[12]

What were the differences between the successful countries and the others? First of all, the labor market was substantially freer in the countries that succeeded in creating new jobs.[13] Second, payroll and income taxes were more than 10 percentage points lower in the five best economies (in terms of job creation) compared to the five worst.[14] Third, the levels of contri-

5 Nicholas Lardy, "Do China's Abusive Labor Practices Encourage Outsourcing and Drive Down American Wages?" testimony before the Senate Democratic Policy Committee, March 29, 2004.

6 Karl Marx and Friedrich Engels, *The Communist Manifesto*, 1848.

7 See European Commission, Eurostat Web site, at *http://epp.eurostat.ec.europa.eu/portal/page?_pageid=1996,39140985&_dad=portal&_schema=PORTAL&screen=detailref&language=en&product=STRIND_EMPLOI&root=STRIND_EMPLOI/emploi/em011*.

8 Olaf Gersemann, *Cowboy Capitalism: European Myths, American Reality* (Washington, D.C.: Cato Institute, 2004).

9 Diana Furchtgott-Roth, "What US Labor Laws Can Teach Europe," *Financial Times*, August 11, 2005.

10 See European Commission, Eurostat Web site, at *http://epp.eurostat.ec.europa.eu/portal/page?_pageid=1996,39140985&_dad=portal&_schema=PORTAL&screen=detailref&language=en&product=Yearlies_new_population&root=Yearlies_new_population/C/C4/C42/ccb30992*.

11 *Ibid.*

12 European Commission, *Employment in Europe 2005*, at *http://ec.europa.eu/employment_social/employment_analysis/employ_2005_en.htm*.

13 Marc A. Miles, Edwin J. Feulner, and Mary Anastasia O'Grady, *2005 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2005).

14 Organisation for Economic Co-operation and Development, *Taxing Wages 2004–2005*, at *http://*

Table 1: Labor Freedom in Europe

EU15/EU25	Nation	Labor Freedom
	Georgia	99.9
EU-15	United Kingdom	82.7
	Armenia	80.9
	Switzerland	78.4
EU-25	Czech Republic	77.2
EU-15	Denmark	74.7
	Bulgaria	71.5
EU-15	Belgium	70.5
EU-15	Luxembourg	70.0
EU-25	Cyprus	70.0
	Iceland	69.9
	Russia	66.2
EU-25	Hungary	66.1
EU-15	France	65.9
	Belarus	64.7
EU-25	Latvia	64.1
EU-25	Slovakia	62.5
	Romania	61.4
	Moldova	61.2
	Albania	60.6
EU-15	Ireland	60.4
EU-25	Lithuania	60.1
EU-25	Malta	60.0
EU-15	Netherlands	59.2
	Macedonia	58.1
EU-15	Italy	57.6
	Bosnia and Herzegovina	57.3
EU-25	Poland	56.2
EU-15	Germany	54.6
EU-15	Finland	53.4
EU-15	Spain	52.7
EU-15	Sweden	52.0
	Croatia	52.0
	Ukraine	51.8
EU-25	Estonia	51.2
	Norway	51.1
EU-25	Slovenia	48.7
EU-15	Greece	48.5
EU-15	Austria	46.8
EU-15	Portugal	46.0
	Turkey	45.4
	Averages	
	EU-15	59.7
	EU-25	60.4
	Non-EU	64.4
	Europe	62.0

Source: Tim Kane, Kim R. Holmes, and Mary Anastasia O'Grady, *2007 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2007), at *www.heritage.org/index*.

bution from the state for unemployment and sick leave were lower in the best economies.[15] What the successful countries have in common are freer labor markets, lower taxes, and lower contributions.

A look at the results for various countries in the labor freedom category in the *Index* provides further proof of the connection between labor freedom and employment. Table 1 shows all of the nations of Europe, including their EU affiliations, ranked according to their labor freedom scores in the 2007 *Index*.

Countries like Georgia, the U.K., Switzerland, and Denmark enjoy higher scores in labor freedom and have experienced better employment outcomes generally. Countries with low scores like Germany, Italy, Portugal, and Sweden have suffered weak employment and outright stagnation.

Comparing the 15 countries that were members of the EU in 1995–2004 to EU-25 and non-EU countries is illustrative. In Britain, the labor market is relatively free and earns a score of 82.7 percent, whereas in Sweden, it is highly regulated and earns a score of 52 percent, compared to the EU-15 average of 59.7 percent. The 10 countries that recently joined the EU have raised their average labor freedom by nearly a full point, but the scores of non-EU economies average nearly five full percentage points higher. Yet the average income between 1995 and 2004 grew by 29 percent in Sweden, 37 percent in EU-15 countries, and 72 percent in Britain. The income of the poorest 10 percent of the population grew by only 10 percent in Sweden, compared to 59 percent in Britain.[16] The worst off were better off where the labor market was freer.

The larger lesson is that Europe's more "advanced" economies have generally created more complex restrictions on labor freedom in the name of protecting workers. This

www.oecd.org/document/40/0,2340,en_2649_37427_36330280_1_1_1_37427,00.html.

15 European Commission, MISSOC (Mutual Information System on Social Protection in the European Union), 2004.

16 Euromonitor, "World Income Distribution 2006/2007," at *www.euromonitor.com/World_Income_Distribution*.

relative wealth has been a convenient excuse for stagnant growth and higher unemployment, but the apology is losing its validity as many Eastern and Middle European countries experiment successfully with freedom.

WHY REGULATION CREATES PROBLEMS

The problems in the countries with substantial state interventions in the labor market are no coincidence. Despite numerous differences between all countries, there are many common features. One common experience is a mismatch between labor supply and demand when restrictions and protections are forced onto the market by government. A highly simplified image of a local labor market may help to shed some light on causes and consequences.

Imagine that your neighbor, having broken a leg, wants your son's help to mow his lawn. He is prepared to pay 20 euros, and your son is willing to do the work for as little as 15 euros. But imagine the state demanding a 50 percent tax. The deal (and work) are taxed out of existence. Or suppose the government demands that the service be performed by a public monopoly, which perhaps charges above 20 euros. Again, your son is without work. Or a labor market regulation demands a minimum wage of 50 euros, and the neighbor is not willing to pay that much. Again, nothing happens. Or a trade union is allowed to deny your son access to your neighbor's lawn because he is not a member of their organization. The result: no job.

Reality, of course, is more complicated, but this example describes in principle some of the most common barriers created by governments in the labor market. The state uses force to raise barriers against free exchange and thereby creates unemployment—all in the name of some "social" policy. It is not difficult to understand why such limitations in the name of protection generate widespread youth unemployment and resentment, resulting in such outcomes as the Paris riots. And there are several ticking bombs like Paris in Western Europe.

In recent years, the Organisation for Economic Co-operation and Development (OECD) has published a number of studies that confirm these connections in its member countries.[17] Government interventions in the labor market produce serious negative effects in terms of unemployment, especially among young people and immigrants. To some extent, this is also the intention. Trade unions are a cartel dedicated to limiting competition. Regulations against firing workers prevent old jobs from being replaced by new ones. It is common knowledge that allowing such interventions does produce adverse effects, but some people seem ready to accept those effects—for example, in order to win elections.

OBSTACLES TO FREE-MARKET REFORM

When the government of France proposed a limited deregulation of the labor market, there were massive protests. Young people demonstrated under slogans like "Regulation!" despite a youth unemployment rate of 22 percent. Fears of neoliberalism were frequently mentioned. Some interpreted this as a lack of understanding among the young French, but there is every reason to believe that many of them knew exactly what they were saying. Many of them were educated and might well have felt certain that they would belong to the privileged group that would have secure jobs in the future, even if others did not.

This well-known phenomenon has been referred to as "insiders and outsiders." Those on the inside are well protected and care more about remaining so than they do about the vast numbers of people on the outside. They

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17 Giuseppe Nicoletti and Stefano Scarpetta, "Product Market Reforms and Employment in OECD Countries," Organisation for Economic Co-operation and Development, *Economics Department Working Paper* No. 472, December 21, 2005; Andrea Bassanini and Romain Duval, "Employment Patterns in OECD Countries; Reassessing the Role of Policies and Institutions," Organisation for Economic Co-operation and Development, *Social, Employment and Migration Working Paper* No. 35, June 2006; *Boosting Jobs and Incomes—Policy Lessons from Reassessing the OECD Jobs Strategy*, Organisation for Economic Co-operation and Development, June 15–16, 2006, at *www.oecd.org/document/19/0,2340,en_21571361_36276310_36276371_1_1_1_1,00.html*.

do not want to give up their own "cradle to the grave" security so that others can have a job. But in a global economy characterized by rapid change and constant restructuring, even formerly secure jobs become insecure; and in a regulated labor market with few new jobs, it is hard to find a new one. Labor market regulations thus tend to create a double insecurity, both for insiders and outsiders.

A broader issue is that labor problems are largely the result of these policies, not something evil created by invisible forces. High taxes on workers make hiring more expensive and working less profitable. Fewer can afford to hire, and the desire to work decreases. Combine that with the possibility of getting contributions from the state for unemployment or sick leave at 80 percent–90 percent of the previous salary, and the result is a so-called unemployment trap in which the economic benefit of going from government support to work is very limited. Those who are permanently on the outside, however, such as people in early retirement, get lower amounts. The government takes a lot of money from those who work to pay millions to those who do not work, and the result should not surprise anyone: fewer people working to support a growing number of people who are dependent on the government.

FORCE LEADS TO MORE FORCE

A central idea of those who favor intervention in the labor market is that people should not work for low wages. Subsidies, minimum wages, and collective bargaining are said to avoid this. The ultimate effect, however, is that people with low productivity become unemployed. These groups, which have grown in size in Western Europe, are often labelled something like "early retired" rather than "unemployed," but no matter what they are called, the effect is the same: They are not allowed to work for low wages, so they have to live their lives dependent instead on low contributions from the state. In many reforming countries, such people are allowed to work and, unlike their counterparts in regulated countries, may rise in competence and salary over time.

There is a tendency in Western Europe to ignore the fact that this system is the cause of many problems, and thus to avoid gradually liberalizing it. Instead, regulation tends to create more regulation, and government force leads to more force. It has become clear to most politicians that productive activities create wealth, but since the current system puts barriers in the way, too little work is performed. Many politicians also understand that big public welfare monopolies and social security will be hard to finance in the future, so they talk with increasing frequency about people "having to work more." Instead of deregulating and making work more profitable, which would boost people's willingness to work, they keep the regulations and talk about duty and discipline. This is contrary to national survival, not just to economic freedom.

PROTECTIONISM OR FREE MARKETS?

In Western Europe, the two most common fears are of companies moving out and people moving in. In turn, this triggers various protectionist opinions and policies. In France, such policies have been labelled "economic patriotism," which is in fact a continuing *de facto* endorsement of big government, more intrusive regulations, and more barriers to the world. To a large extent, the fears are exaggerated: Not many jobs have left, and immigration has been limited, though both are likely to increase. Mainly, these fears are founded on a misunderstanding of the market and the effects of regulation.

It might be regarded as a weakness of free economies that it is impossible to say exactly which new goods, services, and jobs will replace the old. In a centrally planned economy, bureaucrats can pretend to know exactly how many people they will put in different factories next year. But the illusion of certainty is not a strength, and uncertainty is not necessarily a weakness. Innovation and the uncoordinated demand of free people are a solid foundation in fact. Nor does this mean the future is impossible to know. We can see broadly what kinds of production have increased as traditional manufacturing employment has declined: in one word, services.

THE NEW JOBS

In recent decades, companies have rapidly been shedding manufacturing jobs throughout Western Europe. What emerges in their stead are service-sector occupations. About 70 percent of the work force in Western Europe today is employed in the service sector. In Ireland, for example, employment in manufacturing has decreased by 10 percent since 2000, but total employment has risen by 10 percent. For every job lost, two new ones have been created; and as before, the new jobs are better, and wages are higher. We know now that the larger the share of services is in the economy, the higher the level of GDP per capita and the lower the level of unemployment.[18]

The single market for goods within the EU has created enormous prosperity and new jobs. A next logical step would be a single market in services, but the European Parliament has approved only a watered-down services directive. Parliament removed sectors that would benefit the most from free trade in services—health care and education—as well as the important and simplifying principle that allows countries to follow the regulations of their countries of origin. The gains could have been substantial indeed; studies have pointed to substantial gains in terms of increased economic growth and employment. The watered-down directive illustrates what happens when protectionism gains ground.

We have every reason to welcome the new. Logic dictates that the old must make way. If we lock up productive resources in the old sectors, the new economy cannot expand. This is always a painful process in the short run for those who are affected. What is a metal worker going to do when his job vanishes, whether it leaves the country or gets taken by a foreigner? We still do not have a society that makes gaining new competence and change profitable enough. The painful fact is that people throughout Western Europe do not have enough new job opportunities. If their governments stopped focusing on how to protect old jobs, we could think more about how to facilitate change to the new.

The prime example of extreme protectionism is the European Agricultural Policy. It is a system of massive tax-paid subsidies, quotas, tariffs, and regulations. What could have been a productive part of society, as agriculture became in New Zealand after deregulation, has instead become a burden. As industrial manufacturing has evolved to utilize less labor, a terrible precedent has been established, and it haunts the policy debate. Manufacturing is, in that sense, the agriculture of our time.

GLOBALIZATION AND CHANGE

The global economy is a consequence of the fact that market theory has been spread to more parts of the world than ever before. International trade and investment have increased sharply during the past 20 years. Barriers to trade and capital have been reduced. The global economy has been growing steadily.

The economic rise of China and India (with GDPs, respectively, that are 650 percent and 350 percent higher today than they were in 1980) has been analyzed extensively.[19] So far, the number of Chinese that have entered the global work force has equaled the size of the U.S. work force, with 80 percent more Chinese on the way. Global poverty has been cut in half in 20 years, from 40 percent to 20 percent of the world's population, using conservative estimates from the World Bank[20] or distributional estimates from Xavier Sala-i-Martin.[21] GDP growth in poor countries that opened up

18 World Bank, *World Development Indicators 2005*, at *http://publications.worldbank.org/ecommerce/catalog/product?item_id=631625*.

19 Statistics from Central Statistical Organisation, India, International Monetary Fund, and Organisation for Economic Co-operation and Development.

20 Shaohua Chen and Martin Ravaillon, "How Have the World's Poorest Fared Since the Early 1980s?" World Bank *Policy Research Working Paper* No. 3341, 2004.

21 See, for example, Chapter 1, "Global Inequality Fades as the Global Economy Grows," in this volume.

to the global economy averaged 5 percent during the 1990s, whereas GDP in poor countries that were protectionist decreased by 1 percent a year.[22]

This has an obvious effect on Western labor markets. The emergence of developing countries creates new and wealthy markets for products from the U.S. and Europe. The fact that these countries gain competence and create healthy business climates implies that they will be able to produce goods and services that they can make available to consumers in the U.S. and Europe. In turn, this enhances global specialization. Currently, quite a few manufacturing, information technology, and service jobs are moving to Southeast Asia. As the productivity of the people in these countries increases, even more high-skilled jobs are likely to depart. It is essential to recognize, however, that rising Asia is not stealing jobs, as in a zero sum game. Rather, the process of development is leading to gains in efficiency that result in less industrial employment on net. Already, China has lost millions of manufacturing jobs.[23]

In a growing global economy, every country can become wealthier, but a country cannot continue to produce the same goods and services when hundreds of millions of Chinese can do it for a fraction of the price. The same restructuring of the business sector and the labor market that has been going on for centuries will accelerate, and a country that wants to be successful must have policies that facilitate that development as much as possible. Public monopolies, high taxes, labor market regulations, and high public contributions to people who don't work do the opposite.

DEMOGRAPHY AND CHANGE

The current problems in the labor market of Western Europe as a consequence of government intervention may grow worse in a time of globalization. The other main trend, which makes reform even more important, is the demographic situation. The average European simply gets older. Fewer people are born, and we live longer. Some politicians seem to deplore this, because they oppose reform. Of course, the fact that we live longer and healthier lives on average is a sign of great progress, but it will nevertheless affect the labor market and government interventions, such as pensions and health care.

In Germany, for example, it is estimated that the population will decrease from today's 82 million to 72 million in 2050. A similar trend is visible in many other European countries. If the same definition of "working age" is applied in the future, the population of working age in Germany will decrease from 56 million to 41 million during the same period, and the population of working age in Italy will decrease from 39 million to 22 million. It might be said that it is hard to predict what the world will be like in 45 years, but in fact everyone who will retire in 2050 is already born. This has effects not only in terms of the number that work and how many they will have to support, but also in terms of growth. If the population decreases by 0.5 percent a year and productivity rises by 0.5 percent a year, growth is zero.[24] Public expenditure would explode in several countries if nothing is done; in Spain, pension costs today amount to 50 percent of public expenditure and would be 80 percent by 2030 if nothing is done.[25]

Greater openness to immigration is often mentioned in this context, and of course it could increase the labor supply. But in time, immigrants also grow older. The real challenge is how older workers are treated and whether they have incentives to continue working if they are healthy in their later years. Today, when workers retire later than the mandatory age, they lose benefits. The OECD has calculated the size of

22 Paul Collier and David Dollar, *Globalization, Growth and Poverty: Building an Inclusive World Economy*, World Bank, 2002.
23 John E. Hilsenrath and Rebecca Buckman, "Factory Employment Is Falling World-Wide," *The Wall Street Journal*, October 20, 2003.

24 Gabriel Stein and Brian Reading, "Baby Boomer's Poverty Trap: Continental/Japanese Ageing," *Monthly International Review*, September 2003.
25 Tito Boeri, "What Are the Options for Pension and Social Security Reforms in Europe?" paper presented at the 747th Wilton Park Conference, Germany, May 17–19, 2004.

this loss, calling it a tax that amounts to between 50 percent and 90 percent in various Western European countries. A free retirement age where the pension rises with the age of retirement does not punish people who want to work longer. In addition, the funding of health care and elderly care turns out to be a problem only if the government continues to demand that those services be tax-funded. To the extent that such programs are funded privately, higher spending ceases to be a major concern. In other words, the perceived difficulties of funding programs for older workers come not from the market, but from government intervention. Fortunately, reforms can solve that.

CONCLUSION

Labor freedom is in turmoil throughout Europe as the nations of the EU are forced to confront inefficiencies in their protectionist policies. In all relevant respects, the labor market is not fundamentally different from other markets. Just as it is in so many other areas of human endeavor, the free market is superior when it comes to labor. Numerous theories and empirical studies confirm the counterproductive results of government intervention and the successes of deregulation.

In Western Europe, reality shows that there is a great need for liberalization in the labor market to allow more new jobs and prosperity to develop. Viewed within the context of globalization and demographics, the need for reform is even stronger. It is also apparent that freedom in the labor market and better social conditions are not opposites. In fact, if the world wants to achieve both more jobs *and* better living standards, freedom is essential.